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In the Supreme Court of the United States

OCTOBER TERM, 1980

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

PORTLAND CEMENT COMPANY OF UTAH

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE PETITIONER

WADE H. MCCREE, JR.
Solicitor General

JOHN F. MURRAY
Acting Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

JONATHAN S. COHEN
DAVID ENGLISH CARMACK
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

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QUESTIONS PRESENTED

Where the depletable "gross income from mining" under Section 613(c)(1) of the Internal Revenue Code of 1954 of an integrated miner-manufacturer of cement must be determined under the "proportionate profits" method, *i.e.*, an allocation of the receipts from the sale of its first marketable manufactured product to the mining phase of its operation in the ratio that its mining costs bear to its total (mining plus nonmining) costs:

1. Whether, in determining the amount of income to be allocated in accordance with the costs ratio, the income is to be computed on the assumption that only cement sold in bulk is respondent's first marketable product, as the decision below held, or that cement sold in bulk and in bags constitutes respondent's first marketable product, in accordance with the governing Treasury Regulations.

2. Whether, in determining the ratio of mining to total costs, post-manufacturing costs of bags, bagging, storage, distribution, and sales should be included in the proportionate profits computation as nonmining costs, in accordance with the governing Treasury Regulations.

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OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (Pet. App. 1a-11a) are unofficially reported at 36 T.C.M. 578. The opinion of the court of appeals (Pet. App. 12a-16a) is reported at 614 F.2d 724.

JURISDICTION

The judgment of the court of appeals was entered on February 5, 1980 (Pet. App. 17a). By order dated April 24, 1980, Mr. Justice White extended the time for filing a petition for a writ of certiorari to and including June 4, 1980. The petition was filed on June 3, 1980, and was granted on October 6, 1980 (J.A. 118). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of Sections 611 and 613 of the Internal Revenue Code of 1954 (26 U.S.C.), Treasury Regulations 118 (1939 Code), Section 39.23(m)-1, and Treasury Regulations, Sections 1.613-3, 1.613-4, 1.613-5 (26 C.F.R.), are set forth in the Appendix, *infra*, 1a-26a.

STATEMENT

A. The proportionate profits method

Section 611(a) of the Internal Revenue Code of 1954 (App., *infra*, 1a) authorizes a "reasonable allowance for depletion" of natural deposits "in all cases to be made under regulations prescribed by the

Secretary or his delegate." In the case of hard minerals, the allowance is a specified percentage of "gross income from mining." Section 613(a) and (b) of the 1954 Code (App., *infra*, 1a-4a). The rate for calcium carbonate rock, from which cement is made, was 15% for respondent's taxable year ended March 31, 1970, and 14% for its taxable years ended March 31, 1971 and 1972. Section 613(b)(7) of the Code (App., *infra*, 3a-4a).

If a miner simply sells the raw material mined without any further processing, his "gross income from mining" is usually his actual gross receipts from the sales of the raw material. In the case of an integrated miner-manufacturer such as respondent, "gross income from mining" is the miner-manufacturer's constructive income from the raw material product of his mining operations. *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, 86 (1960).

The Treasury Regulations provide two alternative methods for determining the constructive "gross income from mining" of an integrated miner-manufacturer. Under both methods, the constructive figure is derived from actual sales data. If a representative price for the raw material is established by arm's-length sales in a relevant market—by the taxpayer or another miner—that price is the measure of constructive mining income for the raw material which the integrated producer uses in his own manufacturing operations. But if such a representative price cannot be established because the raw material is not generally sold on the open market—as in the integrated cement industry—then the producer's constructive mining income is derived under the proportionate profits method from his own sales price of his manufactured end product.

Under the proportionate profits method, the producer's gross sales receipts are apportioned between mining and total income in the same ratio as the producer's mining costs bear to its overall costs.

The apportionment is reflected in the following equation:

$$\frac{\text{Mining costs}}{\text{Total costs}} \times \text{Gross sales of cement} = \text{Gross income from mining}$$

Treasury Regulations, Section 1.613-4(d)(4)(ii) (App., *infra*, 19a-20a).

B. The Facts of this Case and the Proceedings Below

1. Respondent is a Utah corporation which is an integrated miner-manufacturer of Portland cement. For many years, it has engaged in the quarrying of an argillaceous rock, known as cement rock,[1] and the processing of that rock into finished Portland cement (Pet. App. 2a).

The mining phase of respondent's operations begins with the blasting of the cement rock from the face of the mountainous quarry owned by it. The loose rock is then fed through machinery which reduce the material to a size of less than one square inch. After transportation to a processing plant, the material is ground to a high degree of fineness. During the grinding process, water is added to the powder and a very fine mud, known as "slurry," is formed. The slurry is stored in tanks where it is continuously agitated to maintain a uniform texture. The mining

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[1] Cement rock is chemically known as "calcium carbonate," one of the minerals enumerated in Section 613(b)(7) of the 1954 Code.

phase of respondent's operation concludes at this point. Respondent conducts frequent chemical analyses of the slurry to ensure that it is of a proper composition for making Portland cement (Pet. App. 2a-3a).

During the manufacturing phase of respondent's operations, the liquid slurry is fed into rotary kilns and fired. The heat of the kiln expels moisture from the material and converts carbonates to oxides. As the material is heated to the point of fusion, a hard glass-like substance, known as a clinker, is formed. The clinker is thereafter cooled and ground with purchased gypsum to produce finished cement. After the final grinding, respondent places its finished cement in storage silos to await sales to customers (Pet. App. 3a-4a).

During the taxable years at issue, respondent sold its finished cement in two ways, either in bulk or in bags. Most of respondent's output was sold in bulk in tank cars, which were loaded directly from the storage silos. A small portion of the output was run from the storage silos into a bin above a bagging machine where it was sealed in paper bags in which it was thereafter sold (Pet. App. 4a). The parties have stipulated that the "portion of * * * [respondent's] cement sold in bags is the same material as the cement in bulk" (J.A. 40).

2. On its federal income tax returns for the taxable years ended March 31, 1970-1972, respondent computed its "gross income from mining" in accordance with the proportionate profits method set forth in Treasury Regulations, Section 1.613-4(d)(4) (App., *infra*, 19a-23a). This method has been prescribed by successive Treasury Regulations since

1940.[2] It allocates the sales price of the integrated miner-manufacturer's first marketable product between the mining and nonmining phases of its operations in the same ratio that the costs of its mining process bear to its nonmining costs.

On its tax returns for the years in question, respondent took the position that only bulk cement, and not bulk and bagged cement, constituted its first marketable product. It also excluded from the proportionate profits method formula the costs it incurred for storage, distribution and sales. Respondent reported a greater amount of "gross income from mining" (and thereby claimed a greater depletion base) by applying the proportionate profits computation to the gross sales price of its bulk cement and by excluding the costs of bags, bagging, storage, distribution, and sales from the total costs element set forth in the denominator of the prescribed fraction of the formula (see page 3, *supra*) (Pet. App. 6a; J.A. 46, 52, 58-59, 63, 91-93).

3. On audit, the Commisisoner of Internal Revenue determined deficiencies in respondent's tax liabilities. The Commissioner's position is that: (1) ce-

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[2] See Treasury Regulations 103 (1939 Code), Section 19.23(m)-1(f); Treasury Regulations 111 (1939 Code), Section 29.23(m)-1(f); Treasury Regulations 118 (1939 Code), Section 39.23(m)-(e)(3) (App., *infra*, 5a-7a, 22a-24a). The cited provision of Treasury Regulations 118 continued in force under the 1954 Code (pursuant to Section 7807 of that Code (26 U.S.C.) (see T.D. 6091, 1954-2 Cum. Bull. 47) (Aug. 16, 1954)) until superseded by Section 1.613-3(d)(1)(i) and (ii) of the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) (see T.D. 6965, 1968-2 Cum. Bull. 265 (July 26, 1968)). These Regulations were, in turn, superseded by Section 1.613-4(d)(1) and (4)(i) and (ii) of the Treasury Regulations on Income Tax (1954 Code) (see T.D. 7170, 1972-1 Cum. Bull. 178 (Mar. 15, 1972)).

ment, whether sold in bulk or in bags, constituted respondent's first marketable product, and (2) the costs of bags, bagging, storage, distribution and sales were includable in the "total costs" element in the formula. The Commissioner's computation yielded a greater "total costs" figure, and consequently a reduced amount of "gross income from mining" and a correspondingly smaller depletion base (Pet. App. 1a-2a, 6a; J.A. 16-30, 82-90, 94-99).

Respondent thereafter brought this suit in the Tax Court for redetermination of the deficiencies. The Tax Court upheld respondent's computation and correspondingly larger depletion deduction. Invoking the *Golsen* rule,[3] pursuant to which it follows the law of the circuit to which a case would be appealed, the Tax Court concluded that it was bound by *United States* v. *Ideal Basic Industries, Inc.*, 404 F.2d 122 (10th Cir. 1968), cert. denied, 395 U.S. 936 (1969) (Black and Harlan, JJ., dissenting; White and Marshall, JJ., not participating), rehearing denied, 396 U.S. 975 (1969); and *Portland Cement Co. of Utah* v. *United States*, 412 F.2d 894 (10th Cir. 1969). In so holding, the Tax Court rejected the Commissioner's argument that the Tenth Circuit in *Ideal Basic Industries* never considered the Treasury Regulations explicitly classifying the costs of bags, bagging, storage, distribution, and sales as nonmining costs. Accordingly, the Commissioner urged that the *Golsen* rule was inapplicable because the premises underlying the Tenth Circuit's earlier decisions were not valid (Pet. App. 8a-11a).

The court of appeals affirmed (Pet. App. 12a-17a), noting that "[w]e can add little, if anything, to

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[3] See *Golsen* v. *Commissioner*, 54 T.C. 742 (1970), aff'd on other issues, 445 F.2d 985 (10th Cir.), cert. denied, 404 U.S. 940 (1971).

the analysis made by the Tax Court" (Pet. App. 13a-14a). In so ruling, it considered dispositive its earlier decision in *Ideal Basic Industries*, that " 'bulk cement' is marketable as such, and that under the Regulations it is the 'first marketable product.' The bagged cement is the next stage, and it is, as the Tax Court indicated, the second marketable product" (Pet. App. 14a-15a).

Adhering to the *Ideal Basic Industries* rationale, the court of appeals also rejected the Commissioner's argument that the cement in the bags is the same product as the cement in the bulk silos and his reliance upon the governing Treasury Regulations, Section 1.613-4 (d)(4)(iv) (App., *infra*, 21a-22a). That Regulation explicitly provides that "bulk and packaged products are considered to be essentially the same product." As the court saw the matter, "[i]t is obvious that both are 'cement,' but it is equally apparent that it is 'first marketable' as bulk cement, not as bagged cement" (Pet. App. 15a).

The court of appeals also affirmed the Tax Court's exclusion of respondent's bags, bagging, storage, distribution and sales costs from the "total costs" element in the proportionate profits formula. In support of this aspect of its holding, it adhered to its prior ruling in *Ideal Basic Industries* that "the costs of bagging and of bags were *not* mining costs, and should be excluded under an application of the proportionate costs doctrine" (Pet. App. 15a; emphasis in original). In its view, "[t]hese costs thus had no part there in the determination of the income from the first marketable product. They have no part here when *Ideal Basic* is applied" (*ibid.*).

SUMMARY OF ARGUMENT

1. If a miner does not conduct manufacturing operations with the mineral he extracts from the earth, his "gross income from mining," from which his percentage depletion deduction is derived, is usually his actual gross receipts from the sales of the raw mineral. But in the case of an integrated miner-manufacturer—one who does not sell the raw material he mines, but uses it in his own manufacturing operations—"gross income from mining" is the manufacturer's constructive income from the raw material product of his mining operations.

Section 611(a) of the Code allows a reasonable allowance for depletion "in all cases to be made under regulations prescribed by the Secretary or his delegate." Thus, the Treasury Regulations in the depletion area were issued pursuant to an express congressional authorization to deal with "the multifarious circumstances which would involve questions of depletion." *Douglas* v. *Commissioner*, 322 U.S. 275, 281 (1944). As the Court has long recognized, such Regulations are legislative in character and are therefore entitled to deference similar to that accorded the statute itself. *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501 (1948).

Since 1940, the Regulations have provided for the use of a proportionate profits method to compute the depletion deduction of an integrated miner-manufacturer under circumstances where there is no representative (arm's-length) price for the raw material mined. Under that method gross income from mining is computed in accordance with the following equation:

$$\frac{\text{Mining costs}}{\text{Total costs}} \times \text{Gross sales of manufactured product} = \text{Gross income from mining}$$

The central premise of the method is that every dollar of the total costs of mining and nonmining earns its proportionate part of the total profits, and consequently its proportionate part of gross sales.

The objective of the proportionate profits method is to identify the portion of an integrated producer's gross sales that has been produced by the costs of his mining operations; that portion is the producer's constructive mining income. In substance, the method apportions gross sales receipts of the producer's first marketable product between mining and total income in the same ratio that the producer's mining costs bear to its total costs. By limiting the "gross sales" element to the proceeds derived from sales of the "first marketable product," the formula properly excludes income derived from manufacturing operations which "destroy the physical or chemical identity of the minerals or permit them to be transformed into new products" (*United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, 86 (1960)). Because such manufacturing income is entirely unrelated to mining, it has no place in a formula designed to measure depletable gross income.

2. a. This case involves two questions relating to the application of the proportionate profits method to an integrated miner-manufacturer of cement.

The court of appeals first ruled that respondent's "gross sales of cement" should be determined on the assumption that its first marketable product was cement sold in bulk, rather than in bulk and in bags, as

was in fact the case. In so holding, the court adhered to its prior decisions in *United States* v. *Ideal Basic Industries, Inc.*, 404 F.2d 122 (10th Cir. 1968), cert. denied, 395 U.S. 936 (1969) (Black and Harlan, JJ., dissenting, White and Marshall, JJ., not participating), rehearing denied, 396 U.S. 975 (1969); and *Portland Cement Co. of Utah* v. *United States*, 412 F.2d 894 (10th Cir. 1969).

But the conclusion that cement in bulk is a qualitatively different product from cement sold in bags materially distorts the application of the proportionate profits method. Under that method, respondent's first marketable product is unquestionably finished Portland cement, the end result of its combined mining and manufacturing operations. Bulk cement and cement sold in bags is plainly the same product. Indeed, the parties have so stipulated (J.A. 40). The container for that product—whether it be a tank car supplied by the customer or a bag supplied by the respondent—does not alter the physical or chemical characteristics of the cement. Since the proportionate profits method requires an allocation of the actual gross receipts received on the sale of that production, that allocation must be determined solely on the basis of the prices in fact charged for the commodity regardless of variations in packaging. The pertinent Regulations (Section 1.613-4(d)(4)(iv)), which must be accorded great weight, explicitly state that "bulk and packaged products are to be considered essentially the same product" and provide a specific reference to the cement industry that covers this case. Accordingly, the exclusion from gross sales of any part of the sales proceeds of any cement will not yield the correct amount of gross income from mining under the proportionate profits formula.

b. The Tenth Circuit's decision in *Ideal Basic Industries*, which it followed in the instant case, stands alone as the only appellate authority to reject the direction of the Regulations defining "first marketable product" generally, and particularly in the case of cement. Prior to that decision, the Third Circuit in *Whitehall Cement Manufacturing Co.* v. *United States*, 369 F.2d 468 (1966), had upheld the inclusion of bagged cement in the first marketable product. Moreover, since *Ideal Basic Industries*, the Ninth Circuit in two separate cases and the Fifth Circuit have explicitly rejected the Tenth Circuit's rationale that bagged cement is a separate or different product. The contrary holding of the Tenth Circuit defies the laws of chemistry and is without logical basis.

3. The decision below likewise erred in excluding respondent's post-manufacturing costs of bags, bagging, storage, distribution and sales from the "total costs" denominator element of the formula. Here again, the court of appeals stands alone as the only circuit adhering to this view, which is at odds with the explicit direction of the pertinent Treasury Regulations. The Third, Fourth, Fifth, and Ninth Circuits have correctly upheld the inclusion of these post-manufacturing costs in the formula in accordance with the Regulations. The Court of Claims has also sustained the Commissioner's position.

It is undisputed that these costs are non-mining costs and therefore part of the total costs. Indeed, the court below so acknowledged (Pet. App. 15a). The Tenth Circuit's exclusion of these costs from the formula is a consequence of its erroneous initial holding that the first marketable product was bulk cement. It therefore concluded that all of the expenses incurred after the production of bulk cement "are not a proper part of the computation." *United States* v. *Ideal Basic Industries*, *supra*, 404 F.2d at 126.

But no expenses incurred in producing and selling the first marketable product may be eliminated from the proportionate profits formula without compromising the integrity of its underlying accounting theory of allocating gross sales in accordance with the ratio of mining costs to *total* costs. To exclude the post-manufacturing costs of bags, bagging, storage, distribution and sales from the formula is in effect to put part of these costs and their allocable share of profits within the depletion base. As the dissenting judge observed in *Ideal Basic Industries*, in terms that are equally applicable here, this decision "reaches a result that is a rejection of the basic theory of the proportionate profit method itself" (404 F.2d at 127).

ARGUMENT

ALL OF RESPONDENT'S POST-MANUFACTURING COSTS INCURRED IN DISTRIBUTING AND SELLING ITS CEMENT MUST BE INCLUDED IN THE "TOTAL COSTS" OF THE PROPORTIONATE PROFITS FRACTION FOR COMPUTING ITS DEPLETABLE "GROSS INCOME FROM MINING" BECAUSE ITS FIRST MARKETABLE PRODUCT IS CEMENT, WHETHER SOLD IN BULK OR IN BAGS

A. The Theory of the Proportionate Profits Method Requires that Every Dollar of Costs that Produces Gross Sales Must Enter Into the Computation and that Every Dollar of Such Costs Produces the Same Percentage of Profits

Section 611(a) of the Internal Revenue Code of 1954 (App., *infra*, 1a) provides in pertinent part that in "the case of mines, * * * [and] other natural deposits, * * * there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion * * *, according to the peculiar

conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate." In the case of hard minerals, the allowance is a specified percentage of "gross income from mining." Section 613(a) and (b) of the 1954 Code (App., *infra*, 1a-2a).[4] As this Court has declared on many occasions, the depletion allowance "is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312 (1956); *Helvering* v. *Bankline Oil Co.*, 303 U.S. 362, 366 (1938); *Parsons* v. *Smith*, 359 U.S. 215, 220 (1959); *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, 86 (1960); *Anderson* v. *Helvering*, 310 U.S. 404, 408 (1940).

If a miner does not conduct manufacturing operations, *i.e.*, if he does not "destroy the physical or chemical identity of the minerals or permit them to be transformed into new products" (*United States* v. *Cannelton Sewer Pipe Co.*, *supra*, 364 U.S. at 86), his "gross income from mining" is usually his actual gross receipts from the sales of the raw material. In the case of an integrated producer such as respondent—one who does not sell the raw material he mines, but uses it in his own manufacturing operations—"gross income from mining" is the producer's

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[4] The rate for calcium carbonate rock, from which cement is made, was 15% for respondent's taxable year ended March 31, 1970, and 14% for its taxable years ended March 31, 1971 and 1972. Section 613(b)(7) (App., *infra*, 2a-4a).

gross income constructively attributed to the raw mineral product of his mining operations (*ibid.*).[5]

Since 1940, the Treasury Regulations (now embodied in Section 1.613-4(c)(1) and Section 1.613-4 (d)(1)(i) and (3) (26 C.F.R.)) have provided two different methods for determining the constructive "gross income from mining" of an integrated miner-manufacturer. Under each method, the constructive figure is derived from proceeds attributable to the integrated miner's raw material product. As we have explained (*supra*, page 2), the taxpayer can, if circumstances warrant, employ a representative price as the measure of his constructive mining income for the raw material that the integrated producer uses in his own manufacturing operations. However, respondent, and the members of the integrated cement industry, were not able to establish a representative price because the raw material they use is not generally sold on the open market. Hence, respondent computed its constructive mining income under the proportionate profits method from his gross income from sale of the manufactured end product.

The objective of the proportionate profits method is to identify the portion of an integrated producer's gross sales that has been produced by the costs of his mining operations. That portion is the producer's constructive gross income from mining and the depletion base against which the depletion allowance is claimed. Accordingly, the method apportions gross

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[5] Under Section 613(c)(2) and (c)(4)(F) of the Code (App., *infra*, 4a-5a), in the case of an integrated miner-manufacturer of cement, the "mining" process terminates with the preparation of kiln feed and its transportation to the mouth of the kiln. The kiln firing process and subsequent operations are nonmining processes.

sales receipts between mining and nonmining income in the same ratio that the producer's mining costs bear to its nonmining costs.

The apportionment is reflected in the following equation: [6]

$$\frac{\text{Mining costs}}{\text{Total costs}} \times \text{Gross sales of cement} = \text{Gross income from mining}$$

Treasury Regulations, Section 1.613-4(d)(4)(ii) (App., *infra*, 19a-20a).[7]

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[6] This equation was first set forth in Section 1.613-3(d)(1)(ii), Treasury Regulations on Income Tax (1954 Code), on July 25, 1968. T.D. 6965, 1968-2 Cum. Bull. 265. Several courts had decided that the same equation was applicable under Section 39.23(m)-1(e)(3) of Treasury Regulations 118 (1939 Code) (App., *infra*, 6a-7a). See, *e.g.*, *Whitehall Cement Manufacturing Co.* v. *United States*, 369 F.2d 468, 471 (3d Cir. 1966); *Riddell* v. *California Portland Cement Co.*, 330 F.2d 16, 17 (9th Cir. 1964); *General Portland Cement Co.* v. *United States*, 628 F.2d 321 (5th Cir. 1980).

[7] The "proportionate profits" method of determining "gross income from mining," now set forth in Treasury Regulations, Section 1.613-4(d)(4), first appeared in 1940 in Treasury Regulations 103 (1939 Code), Section 19.23(m)-1(f). It might then and now have been referred to with equal accuracy and greater clarity as the proportionate *proceeds* method because, as the Tax Court aptly stated, "[t]he purpose of the proportionate-profits formula is to separate the sales price of a product into its mining and nonmining components." *North Carolina Granite Corporation* v. *Commissioner*, 56 T.C. 1281, 1291 (1971). Profits, as such, have little or no relevance in this context. If, however, one makes the assumption on which the formula is based, that profits from mining and from nonmining operations are in the same ratio as mining costs and nonmining costs, then mining costs plus mining profits will yield proceeds from mining, or "gross income from mining."

The basic theory of the method is that every dollar of the producer's costs, mining and nonmining alike, is deemed to produce the same proportionate part of the proceeds from sales of the first marketable product; it is the gross receipts from such sales that are apportioned in accordance with the cost ratio. Treasury Regulations, Section 1.613-4(d)(4)(i) (App., *infra*, 19a). As the Court of Claims correctly observed in *Standard Lime and Cement Co.* v. *United States*, 329 F.2d 939, 944 (1964): "[E]ach dollar of costs expended to *produce and sell* the end product earns the same percentage of the profit" (emphasis supplied). The pertinent Treasury Regulation (Section 1.613-4(d)(4)(i)) (App., *infra*, 19a) therefore provide: "Accordingly, in the proportionate profits method no ranking of costs is permissible which results in excluding or minimizing the effect of any costs incurred to produce, sell, and transport the first marketable product or group of products." The premise that every dollar of costs produces the same ratable part of the proceeds is in accord with long-settled principles of corporate accounting. See Paton and Littleton, *An Introduction to Corporate Accounting Standards* 67 (American Accounting Association 1940).

Two fundamental principles therefore emerge with respect to the allocation of gross sales between mining and nonmining income under the proportionate profits method. First, every dollar of costs that has produced gross sales must enter into the computation. Second, every dollar of such costs is deemed to earn the same percentage of gross sales. No expenses may be eliminated from the proportionate profits method, for the underlying accounting theory of that method is abrogated unless a producer's gross sales

are allocated in accordance with a cost fraction which includes in its denominator *all* of the costs producing the sales.

The determination of the integrated miner-manufacturer's "gross income from mining" requires an allocation of all its income from sales of the first marketable product between the mining and nonmining phases of the company's operations. All costs and all of the profit must be allocated to either the mining or the nonmining part of the operation. If an item of expense in fact results from the mining phase of the business, it should be included in the "gross income from mining," and also carry into "gross income from mining" its ratable share of the company's profit or loss. By the same token, every cost that is attributable to the nonmining operations, together with its allocable share of profit or loss, must be excluded from the depletion base by adding it to the denominator of the fraction "Total costs." If nonmining costs are not so added to the denominator of the formula, the proportionate profits formula will be distorted and the depletion allowance will thereby not be restricted to its intended scope—the return of the miner's capital interest in depletable minerals.

B. Respondent's first marketable product is cement, whether sold in bulk or in bags

1. Once it is recognized that the integrity of the proportionate profits method requires the inclusion in the formula on an equal basis of all costs incurred to produce the first marketable product, the error of the decision below becomes apparent. The court of appeals here ruled that respondent's gross sales of cement should be determined on the assumption that all its cement was sold in bulk, rather than in bulk and in bags (Pet. App. 14a-15a).

But the conclusion that cement in bulk is a qualitatively different product from cement sold in bags and is therefore respondent's first marketable product materially distorts the application of the proportionate profits method. Under that method, the nature of the first marketable product depends upon its physical and chemical characteristics. See *United States* v. *Cannelton Sewer Pipe Co.*, *supra*, 364 U.S. at 85-86. Neither the quantities nor the packages in which it is sold, and which determine the per unit price, affect the nature of the product. Cement sold in bulk and cement sold in bags are unquestionably the same product. The container for that product—whether it be a tank car supplied by the customer or a bag supplied by respondent—does not alter the physical or chemical characteristics of the cement. Indeed, the parties have stipulated that bulk and bagged cement is the same product (J.A. 40). The proportionate profits method requires an allocation of the actual gross receipts received upon the sale of that product, and that must be determined solely on the basis of the prices in fact charged for the commodity regardless of variations depending upon such things as packaging. To exclude from gross sales any part of the sales proceeds of any cement will not yield the correct amount of gross income from mining under the proportionate profits formula upon which the statute allows percentage depletion.

2. The foregoing analysis is squarely supported by the terms of the governing Treasury Regulations, which define first marketable product with particular reference to the cement industry. Sections 1.613-3(d)(1)(iv) and 1.613-4(d)(4)(iv) of the Regulations (App., *infra*, 8a, 21a) provides that the term "first marketable product" means "the product * * * pro-

duced by the taxpayer as a result of the application of nonmining processes, in the form or condition in which such product or products are first marketed in significant quantities by the taxpayer or by others in the taxpayers' marketing area." The Regulation further states that "For this purpose, bulk and packaged products are considered to be essentially the same product." Finally, in terms explicitly directed to the question presented in this case, the Regulation illustrates the definition with the following example: "* * * [I]f a cement manufacturer sells his own finished cement of various types in bulk and bags and also sells concrete blocks or dry ready-mix aggregates containing additives, the finished cement of various types, in bulk and bags, constitutes the first marketable product or group of products produced by him."

As we have noted at the outset of our argument (*supra*, pages 12-15), Section 611(a) of the Code authorizes a reasonable allowance for depletion with the proviso that "such reasonable allowance in all cases [is] to be made under regulations prescribed by the Secretary or his delegate." See also 26 U.S.C. 7805(a). Thus, the Regulations upon which we rely are legislative in character insofar as they were issued pursuant to an express congressional authorization to deal with what this Court has described as "the multifarious circumstances which would involve questions of depletion * * *." *Douglas* v. *Commissioner*, 322 U.S. 275, 281 (1944). As the Court has long recognized, such legislative Regulations are entitled to deference similar to that accorded the Code itself unless deemed to be contrary to the statutory authorization or unreasonable. *Com-*

missioner v. *South Texas Co.*, 333 U.S. 496, 501 (1948). Such Regulations therefore have the force and effect of law and "will not be overruled except for weighty reasons." *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378 (1931). See also *Brewster* v. *Gage*, 280 U.S. 327, 336 (1930). Indeed, the legislative delegation and deference to the "masters of the subject" (*United States* v. *Moore*, 95 U.S. 760, 763 (1878)) in the depletion area is particularly appropriate. In this context, the Court has recognized a special need for broad discretion by those charged with the administration of the tax law. "[T]he highly technical and involved factors entering into a practical solution of the problem of depletion in administration of the tax laws points to the necessity of interpreting * * * [the applicable statute] so as to strengthen rather than to weaken the administrative powers to deal with it equitably and reasonably." *Helvering* v. *Wilshire Oil Co.*, 308 U.S. 90, 103 (1939).

2. Given the explicit command of the Regulations that respondent's first marketable product is cement, whether sold in bulk or in bags, and the consistency of that definition with the purpose of the proportionate profits method, it is hardly surprising that apart from the court below, every other court of appeals has sustained the Commissioner's definition of first marketable product as finished cement, in bulk and bags. Indeed, in *Whitehall Cement Manufacturing Co.* v. *United States*, 369 F.2d 468 (1966), the Third Circuit upheld the Commissioner's position even prior to the 1968 promulgation of the definition of "first marketable product" in the Treasury Regulations. There, the taxpayer likewise argued that the costs incident to and premiums charged for cement sold in bags should be excluded from the proportionate

profits calculation, on the theory that the bagging costs were more than the premium so that those costs could not fairly be considered to have produced a proportionate share of the manufacturer's overall profits. The court rejected this argument as resting on (369 F.2d at 474) "an erroneous assumption that the packaging costs produced only the additional revenue derived from the premiums * * *. It seems reasonable to infer that the profits realized from the sale of packaged cement, and these were substantial, were attributable at least in part to the packaging costs." The court therefore held that the packaging costs must be included in the denominator of the proportionate profits equation as a nonmining cost and that the profits attributable to such costs should be included in gross sales (*ibid.*).

Similarly, in *United States* v. *California Portland Cement Co.*, 413 F.2d 161 (1969), the Ninth Circuit held that the first marketable product was finished cement, regardless of the form of its packaging. There, as here, the taxpayer argued that its profits resulting from sales of bagged cement should be excluded from the proportionate profits formula on the ground that the first marketable product obtained from the calcium carbonate rock was bulk cement. But the Ninth Circuit rejected this contention, citing with approval the explicit direction of Treasury Regulations, Section 1.613-3(d)(1)(iv) (App., *infra*, 8a) that "bulk and packaged products are considered to be essentially the same product" and that with respect to a cement manufacturer, "the finished cement of various types, *in bulk and bags*, constitutes the first marketable product or group of products produced by him" (emphasis added).

In so ruling, the Ninth Circuit observed (413 F.2d at 169) that the treatment of bag and bagging costs by the court below in *United States* v. *Ideal Basic Industries, Inc.*, 404 F.2d 122 (10th Cir. 1968), cert. denied, 395 U.S. 936 (1969) (Black and Harlan, JJ., dissenting, White and Marshall, JJ., not participating), rehearing denied, 396 U.S. 975 (1969), was not consistent "with other language of that opinion * * *" that states that " 'the sales price of the first marketable product is to be computed on the identical physical material that is represented by total mining and non-mining costs' " (404 F.2d at 125 n.1). Moreover, the Ninth Circuit (413 F.2d at 170) agreed with the conclusion of the dissenting judge in *Ideal Basic* that "[t]o eliminate all post-manufacturing costs destroys consideration of the representative market or field price of the first marketable product, a prime factor in the application of the equation, and thus seems * * * to reject the method itself" (404 F.2d at 128).[8]

Finally, most recently in *General Portland Cement Co.* v. *United States*, 628 F.2d 321 (1980), the Fifth Circuit has likewise upheld the Commissioner's position that the first marketable product in these cases is finished cement, whether in bulk or bagged form. In so holding, the court rejected the "simple logic" of *Ideal Basic*, to which the court below adhered, that "Bulk cement is the first marketable

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[8] The Ninth Circuit's decision in *California Portland Cement Co.* was issued on June 4, 1969, two days after this Court denied certiorari in *Ideal Basic Industries*. Although we called the attention of the Court to that decision in a petition for rehearing in *Ideal Basic Industries*, the Court denied rehearing (396 U.S. 975 (1969) (White and Marshall, JJ., not participating)).

product because it *can* be sold" (404 F.2d at 126 n.2) (emphasis in original) and that "bagged cement is the second marketable product (footnote omitted)" (*id.* at 126). As the Fifth Circuit correctly responded, "Even if we assume, with those cases, that bulk cement is the first marketable product, it does not follow therefrom that bagged cement is a separate or different product. That is, it does not follow that bagged cement is the second marketable product. Rather, bagging is simply a way of getting the same product, namely cement, to market. Some customers might want cement in rail cars, some in trucks, some in barges, some in 'piggy-back' containers, and some in bags. The product, however, remains cement (footnotes omitted)." 628 F.2d at 332-333.[9]

It is therefore clear that the additional gross sales received by respondent from the premium it charged for bagged cement must be included in the "gross sales" figure of the proportionate profits formula. The act of putting finished cement in a bag is not a nonmining process that alters the chemical form or condition of the cement. There is accordingly no difference between bulk and bagged cement for purposes of determining the proceeds derived from sales of respondent's first marketable product. Under the proportionate profits formula, "gross sales" of the

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[9] The district court's opinion in that case (*General Portland Cement Co.* v. *United States*, 438 F. Supp. 27, 35 (N.D. Tex. 1977)) put it much the same way. It stated: "To say that the cement in the truck and barge is the first marketable product is to defy the reality of the marketing process. Both large and small orders are sold as cement; the only difference between the two methods of sale is how the customer receives his cement. Different legal results which depend upon the mere size of the order of cement are simply not rational."

first marketable product for the cement industry must therefore mean gross sales of finished cement, whether in bulk or in bags.

C. The post-manufacturing costs of bags, bagging, storage, distribution and sales should be included in the proportionate profits formula as nonmining costs

It is undisputed that the costs of storing, shipping, bagging and bags are nonmining costs because they are not related to mining operations.[10] The Treasury Regulations (Sections 1.613-4(d)(3)(i) and (iii), 1.613-4(g)(3) and (4)) (App., *infra*, 16a-18a, 24a-25a), so provide;[11] and the court below (Pet. App. 15a) as well as the other courts have so held.[12] With respect to selling expenses, the Treasury Regu-

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[10] Section 613(c)(4)(F) provides that mining includes all processes up to kiln feed "but not including any subsequent process." Subsequent manufacturing and marketing processes are excluded under the statutory scheme. Only those cost items incurred in the processes up to kiln feed may be considered a mining cost. Costs incurred in manufacturing and marketing processes are therefore nonmining costs. The statutory definition is in accord with the basic purpose of the depletion allowance to compensate for the exhaustion of the mineral assets, rather than for the cost of manufacturing and marketing of the end product. *General Portland Cement Co.* v. *United States*, *supra*, 628 F.2d at 323-335, *Standard Lime and Cement Co.* v. *United States*, *supra*, 329 F.2d at 946, 948.

[11] Sections 1.613-3(d)(4)(i) and (iii) and 1.613-4(g)(3) of the Treasury Regulations on Income Tax (26 C.F.R.) (1968) (App., *infra*, 10a-12a, 24a-25a) are substantially the same as Sections 1.613-4(d)(3)(i) and (iii) and 1.613-4(g)(3) of the Treasury Regulations on Income Tax (26 C.F.R.) (1972) (App., *infra*, 16a-18a, 24a-25a).

[12] *General Portland Cement Co.* v. *United States*, *supra*, 628 F.2d at 330-335 (costs of bags, bagging, loading and storing); *United States* v. *California Portland Cement Co.*, *supra*, 413 F.2d at 167-170 (costs of bags and bag-

lations (Section 1.613-4(d)(3)(iv) and 1.613-5(c)(4)(ii)) (App., *infra*, 18a-19a, 26a) provide that they are non-mining costs except when a taxpayer shows that a nonintegrated miner or producer typically incurs selling expenses, in which case such expenses are allocated between mining and nonmining costs. Respondent, however, made no such showing in this case. Accordingly, the courts below correctly held them to be nonmining costs.[13] The only question is whether

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ging); *Southwestern Portland Cement Co.* v. *United States*, 435 F.2d 504, 508-510 (9th Cir. 1970) (costs of shipping, bags and bagging); *Whitehall Cement Manufacturing Co.* v. *United States, supra*, 369 F.2d at 473-474 (costs of bags, bagging and bulk loading); *Standard Lime and Cement Co.* v. *United States, supra*, 329 F.2d at 948-950 (costs of containers, packing, loading and storing); *Mississippi Valley Portland Cement Co.* v. *United States*, 347 F. Supp. 240 (S.D. Miss. 1972) (costs of shipping, marketing and packaging).

[13] Prior to the issuance of the 1972 Treasury Regulations, there was no Regulation resolving the question whether selling expenses were nonmining costs or allocable between mining and nonmining costs. The Commissioner consistently took the position that selling costs were nonmining costs because they were entirely associated with the distribution of finished cement. The Tenth Circuit in *Ideal Basic Industries, supra*, 404 F.2d at 126-127, the Court of Claims in *Standard Lime, supra*, 329 F.2d at 946-947, and the district court in *Mississippi Valley Portland Cement Co., supra*, 347 F. Supp. at 243, all agreed with the Commissioner that selling costs were nonmining costs. On the assumption that nonintegrated miners incur selling expenses, the Ninth Circuit in *California Portland Cement, supra*, 413 F.2d at 170-172, and *Southwestern Portland Cement Co., supra*, 435 F.2d at 508-509, and the Fourth Circuit in *Arvonia-Buckingham Slate Co.*, 426 F.2d 484, 486-487 (1970), held that selling expenses were to be apportioned between mining and nonmining costs. These decisions are not inconsistent with the 1972

these nonmining costs are included as such in the proportionate profits computation.

Just as it does with respect to the first issue, the court below stands alone as the only circuit excluding the post-manufacturing costs of bags, bagging, storage, distribution and sales from the proportionate

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Regulations, but merely assume a fact that these Regulations require the taxpayer to prove.

At all events, the 1972 Regulations are applicable in this case. Those Regulations are applicable by their terms to all years governed by the 1954 Code. T.D. 7170, 1972-1 Cum. Bull. 178. Because they were promulgated prior to the end of respondent's taxable year ended March 31, 1972, there is no issue of retroactivity with respect to that year. Moreover, the 1972 Regulations can apply retroactively to respondent's taxable years ended March 31, 1970 and 1971. As a general rule, Treasury Regulations are applicable retroactively to cover all years governed by the statute under which they are promulgated, as long as they do not contravene the statute or well-settled law. *Dixon* v. *United States*, 381 U.S. 68, 71-75 (1965); *Automobile Club* v. *Commissioner*, 353 U.S. 180, 184 (1957); *Helvering* v. *Reynolds*, 313 U.S. 428, 432-433 (1941); *Manhattan Co.* v. *Commissioner*, 297 U.S. 129, 134-135 (1936); *United States* v. *California Portland Cement Co., supra*, 413 F.2d at 164; *Anderson, Clayton & Co.* v. *United States*, 562 F.2d 972, 976 (5th Cir.), rehearing and rehearing en banc denied, 565 F.2d 1215 (1977), cert. denied, 436 U.S. 944 (1978); *Wilson* v. *United States*, 588 F.2d 1168, 1171 (6th Cir. 1978). The Regulations merely set forth a specific application of the proportionate profits method as it relates to selling expenses. The selling costs are clearly nonmining expenses to the extent that nonintegrated miners had no selling expenses. Without evidence to the contrary, selling expenses are costs incurred in selling the finished cement, not the kiln feed, and are therefore nonmining costs. The allocation of these expenses to nonmining costs, absent proof that nonintegrated miners incur selling costs, correctly restricts the depletion base to the statutory "gross income from mining."

profits computation. All of the other courts of appeals that have considered the question have held that a proportionate part of the profits from the sale of the first marketable product is allocable to these nonmining costs so that they should be included in the proportionate profits formula. *General Portland Cement Co.* v. *United States, supra,* 628 F.2d at 330-335 (costs of bags, bagging, loading and storing). *United States* v. *California Portland Cement Co., supra,* 413 F.2d at 167-172 (costs of bags, bagging, and sales) and *Southwestern Portland Cement Co.* v. *United States,* 435 F.2d 504, 508-510 (9th Cir. 1970) (costs of shipping, bags and bagging and selling); *Arvonia-Buckingham Slate Co.* v. *United States,* 426 F.2d 484 (4th Cir. 1970) (costs of advertising and sales); *Whitehall Cement Manufacturing Co.* v. *United States, supra,* 369 F.2d at 468 (costs of bags, bagging, and bulk loading). See also *Standard Lime & Cement Co.* v. *United States, supra,* 329 F.2d at 939 (costs of containers, packing, loading and storing).[14]

Here, as in its previous decision in *Ideal Basic Industries,* the court below refused to recognize that all of the costs of producing and selling cement had

[14] In *Standard Lime & Cement Co.* v. *United States,* 329 F.2d 939 (1964), the Court of Claims employed a computational approach different from the ratio formula set forth in the current Regulations and adopted by other courts under Treasury Regulations 118. This approach achieves the same end result, however, because the same basic theory was applied. *Standard Lime* reflects the literal description of the proportionate profits method in the 1939 Code Regulations. Under that description, post-manufacturing costs, together with their proportion of the profits, are subtracted from gross sales. This manner of working back from gross sales maintains the proper correspondence between a constructive income figure and related costs at any point in an integrated producer's operations. See the detailed discussion of *Standard Lime* in *General Portland Cement Co.* v. *United States, supra,* 628 F.2d at 328-329.

to be taken into account in determining the costs ratio. It correctly reaffirmed its prior holding that "the costs of bagging and of bags were *not* mining costs * * *" (Pet. App. 15a). But it erroneously refused to apply the basic theory of the proportionate profits method to these costs, in holding that they "should be excluded under an application of the proportionate costs doctrine" (*ibid.*).

By excluding these costs from the denominator (total costs) of the fraction

$$\frac{\text{Mining costs}}{\text{Total costs}}$$

(against which gross sales must be multiplied), the decision below has likewise invalidated Treasury Regulations of a legislative character that are, as we have explained (*supra*, pages 19-20), entitled to great deference. Those Regulations (Sections 1.613-4(d)(3)(i), (iii), and (iv), 1.613-4(g)(3) and (4) (App., *infra*, 16a-19a, 25a-26a) explicitly require that these post-manufacturing costs shall be considered as nonmining costs and that "all profits attributable thereto are treated as nonmining profits" (App., *infra*, 18a-19a).[15] Indeed, as we have pointed out (*supra* page

[15] Both the Tax Court (Pet. App. 9a, 11a) and the court of appeals (Pet. App. 15a) rejected the Commissioner's argument that the Tenth Circuit in *Ideal Basic Industries* never addressed the Regulations that specifically classify bags and bagging costs as nonmining costs and that this error required a reconsideration of that decision. In response, both courts below cited the fact that *Ideal Basic Industries* did not dispute the proposition that the costs of bags and bagging constitutes nonmining expenses (see 404 F.2d at 125). But this conclusion overlooks the further command of the Regulation that "all profits attributable (to nonmining costs such as bags and bagging) be treated as nonmining profits" (App., *infra*, 18a) and must be thereby excluded from the depletion base.

17), no expenses may be eliminated from the proportionate profits formula without compromising the integrity of its underlying theory of allocating gross sales in accordance with the ratio of mining costs to *total* costs. The post-manufacturing costs of bags, bagging,[16] storage, distribution and sales are unquestionably part of total costs. To exclude them from the formula is in effect to put part of the post-manufacturing costs and their allocable share of profits within respondent's depletion base. This distortion is a consequence of the court's requiring the allocation of sales income (erroneously limited to bulk cement) by a ratio that includes only mining and manufacturing costs in the denominator. As the dissenting judge observed in *Ideal Basic Industries*, in terms that are equally appropriate here, this decision "reaches a result that is a rejection of the basic theory of the proportionate profit method itself" (404 F.2d at 127). Accord: *California Portland Cement Co.* v. *United States*, *supra*, 413 F.2d at 169-170, 172; *General Portland Cement Co.* v. *United States*, *supra*, 628 F.2d at 330. The court of appeals' persistent rejection of the basic theory of this well-established method of computing the depletion deduction should be corrected by this Court.

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[16] The fact that the costs of bags and bagging exceeded the premium charged for them (J.A. 102, 105) does not mean that they did not contribute to respondent's profit on the sale of cement. Both the Third Circuit in *Whitehall* (369 F.2d at 474) and the Fifth Circuit in *General Portland* (628 F.2d at 330-331) also concluded that it was reasonable to infer that an integrated miner-manufacturer's sale of bagged cement was an accommodation to customers, induced such sales, and at least partially contributed to substantial profits. Indeed, there is no need even to make such an inference in this case for the parties have stipulated that respondent "realized a net profit on the sale of each bag of cement" (Supp. Stip. ¶ 4; J.A. 103).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

JOHN F. MURRAY
Acting Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

JONATHAN S. COHEN
DAVID ENGLISH CARMACK
Attorneys

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 611. ALLOWANCE OF DEDUCTION FOR DEPLETION.

(a) *General Rule.*—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. For purposes of this part, the term "mines" includes deposits of waste or residue, the extraction of ores or minerals from which is treated as mining under section 613(c). In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this section for subsequent taxable years shall be based on such revised estimate.

* * * * *

SEC. 613. PERCENTAGE DEPLETION.

(a) [as amended by Section 13(e), Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960] *General Rule.*—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section

611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). For purposes of the preceding sentence, the allowable deductions taken into account with respect to expenses of mining in computing the taxable income from the property shall be decreased by an amount equal to so much of any gain which (1) is treated under section 1245 (relating to gain from disposition of certain depreciable property) as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231, and (2) is properly allocable to the property. In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

(b) *Percentage Depletion Rates.*— * * *

* * * * *

(7) [as amended by Section 302(a), Public Debt and Tax Rate Extension Act of 1960, Pub. L. No. 86-564, 74 Stat. 290; Section 6(a), Act of September 2, 1964, Pub. L. No. 88-571, 78 Stat. 857; Sections 208(a) and 209(a), Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1539. In effect for tax years beginning on or prior to October 9, 1969.] 15 percent—[a]ll other minerals (including, but not limited to, aplite, barite, borax, calcium carbonates, di-

atomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, mollusk shells (including clam shells and oyster shells), phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (1)(C) does not apply) bauxite, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc, including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral (other than slate to which paragraph (5) applies) when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, dirt, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

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(7) [as amended by Section 501(a), Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487; Section 501(b)(2), Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26. In effect for tax years beginning after October 9, 1969.] 14 percent—[a]ll other

minerals, including, but not limited to, aplite, barite, borax, calcium carbonates, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, mollusk shells (including clam shells and oyster shells), phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (1)(C) does not apply) bauxite, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc (including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral (other than slate to which paragraph (5) applies) when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, dirt, turf, water or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

(c) [as amended by Section 302(b)(1) and (2), Public Debt and Tax Rate Extension Act of 1960, *supra*] *Definition of Gross Income From Property.*—For purposes of this section—

(1) *Gross income from the property.*—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) *Mining.*—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

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(4) *Treatment processes considered as mining.*—* * *

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(F) in the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln food into the kiln, but not including any subsequent processes;

* * * * *

Treasury Regulations 118 (1939 Code):

§ 39.23(m)-1 *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*

* * * * *

(e) As used in sections 114(b)(3) and 114(b)(4)(A) and §§ 39.23(m)-1 to 39.23(m)-19, inclusive, the term "gross income from the property" means the following:

* * * * *

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and

the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

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Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.613-3. *Gross income from the property.*

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(d) *Sales after the application of nonmining processes where a representative market or field price cannot be ascertained*—(1) *Computation of gross income from the property by use of the proportionate profits method.*

* * * * *

(iii) Those costs which are paid or incurred by the taxpayer to produce, sell, and transport the first marketable product or group of products, and which are not directly identifiable with either a particular mining process or a particular nonmining process shall be properly apportioned to mining and to nonmining. In the absence of any specific provision of this section providing an apportionment method, such costs shall be apportioned by use of a method which is reasonable in the circumstances. One method which may be reasonable in a particular case is an allocation based on the proportion that the direct costs of mining processes and the direct costs of nonmining processes bear to each other.

For example, the salary of a corporate officer engaged in overseeing all of the taxpayer's processes is an expense which would normally be apportioned on the basis of the ratio between the direct costs of mining and nonmining processes. On the other hand, an expense such as workmen's compensation premiums would normally be apportioned on the basis of direct labor costs. For the rule relating to selling expenses, see paragraph (c) of § 1.613-4.

(iv) As used in this section, the term "first marketable product or group of products" means the product (or group of essentially the same products) produced by the taxpayer as a result of the application of nonmining processes, in the form or condition in which such product or products are first marketed in significant quantities by the taxpayer or by others in the taxpayer's marketing area. For this purpose, bulk and packaged products are considered to be essentially the same product. The first marketable product or group of products does not include a product or group of products additionally refined, beneficiated, altered, or manufactured as a result of the application of additional nonmining processes. For example, if a cement manufacturer sells his own finished cement of various types in bulk and bags and also sells concrete blocks or dry ready-mix aggregates containing additives, the finished cement of various types, in bulk and bags, constitutes the first marketable product or group of products produced by him. Similarly, if an integrated iron ore and steel producer sells both pig iron in various sizes and rolled sheet iron or shapes, his

first marketable product is the pig iron in its various sizes. Further, if an integrated clay and brick producer sells both unglazed bricks and tiles of various shapes and sizes and additionally manufactured bricks and tiles which are specially glazed, the unglazed products, both packaged and unpackaged, constitute his first marketable product or group of products.

(v) As used in this paragraph, the term "gross sales (actual or constructive)" means the total of the taxpayer's actual sales to others of the first marketable product or group of products, plus the taxpayer's constructive sales of the first marketable product or group of products used or retained for use in his own subsequent operations. The prices at which actual or constructive sales are made are to be determined in accordance with the principles set forth in this paragraph and in paragraphs (b), (c), and (e) of this section, as appropriate. In the case of constructive sales of the taxpayer's first marketable product or group of products, the taxpayer shall attach to his return a statement indicating the price or prices used by him in computing the representative market or field price for such product or products, and the source of his information as to such price or prices. The prices at which actual or constructive sales are made shall not be determined by reference to prices established in transactions between members of a controlled group. See paragraph (a) of § 1.482-1 for the definitions of the terms "controlled" and "group".

* * * * *

(4) *Treatment of particular items in computing gross income from the property by use of the proportionate profits method or another approved method based on the taxpayer's costs.* (i) Except as specifically provided elsewhere in this section, when determining gross income from the property by use of the proportionate profits method or any other approved method which is based on the taxpayer's costs, the costs attributable to mining transportation shall be treated as mining costs, and the costs attributable to nonmining transportation shall be treated as nonmining costs. Accordingly, except as specifically provided elsewhere in this section, all profits attributable to mining transportation shall be treated as mining profits, and all profits attributable to nonmining transportation shall be treated as nonmining profits. For this purpose, mining transportation means so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to plants or mills in which other mining processes are applied thereto as is not in excess of 50 miles or, if the taxpayer files an application pursuant to paragraph (h) of this section and the Commissioner finds that both the physical and other requirements are such that the ores or minerals must be transported a greater distance to such plants or mills, the transportation over the greater distance. Further, for this purpose, nonmining transportation includes the transportation (whether or not by common carrier) of ores, minerals, or the products produced therefrom, from the point of extraction from the ground to nonmining facili-

ties, or from a mining facility to a nonmining facility, or from one nonmining facility to another, or from a nonmining facility to the customers who purchase the taxpayer's first marketable product or group of products. See paragraph (e)(2) of this section for provisions relating to purchased transportation to the customer, and paragraph (g)(3) of this section for provisions relating to transportation the primary purpose of which is marketing or distribution. In the absence of other methods which the district director determines will clearly reflect the costs of the various phases of transportation, the cost attributable to nonmining transportation shall be an amount which is in the same ratio to the costs incurred for the total transportation as the distance of the nonmining transportation is to the distance of the total transportation. Where the plants or mills in which mining processes are applied to ores or minerals are in excess of 50 miles from the point of extraction from the ground (or in excess of a greater distance approved by the Commissioner), the costs incurred for transportation to such plants or mills in excess of 50 miles (or of such greater distance) shall be treated as nonmining costs in determining gross income from mining. Accordingly, all profits attributable to such excess transportation are treated as nonmining profits. However, except in the case of transportation performed in conveyances owned or leased by the taxpayer, the preceding sentence shall apply only to taxable years beginning after November 30, 1968.

* * * * *

(iii) In determining gross income from the property by use of the proportionate profits method (or any other approved method which is based on the taxpayer's costs)—

(a) The costs attributable to containers, bags, packages, pallets, and similar items as well as the costs of materials and labor attributable to bagging, packaging, palletizing, or similar operations shall be considered as nonmining costs.

(b) The costs attributable to the bulk loading of manufactured products shall be considered as nonmining costs.

(c) The costs attributable to the operation of warehouses or distribution terminals for manufactured products shall be considered as nonmining costs.

Accordingly, all profits attributable thereto are treated as nonmining profits.

(iv) In computing gross income from the property by means of the proportionate profits method or any other approved method based on the taxpayer's costs, the principles set forth in paragraph (c) of § 1.613-4 shall apply when determining whether selling expenses and trade association dues are to be treated, in whole or in part, as mining costs or as nonmining costs. To the extent that selling expenses and trade association dues are treated as nonmining costs, all profits atributable thereto are treated as nonmining profits.

* * * * *

(e) *Reductions of sales price in computing gross income from the property*— * * *

* * * * *

(2) *Purchased transportation to the customer.* * * *

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(ii) In the case of a taxpayer computing gross income from mining under the provisions of paragraph (d) (1) of this section, the cost of purchased transportion to the customer (as defined in subdivision (iii) of this subparagraph) shall be excluded from the taxpayer's gross sales of his first marketable product or group of products (after any adjustments required by subparagraph (1) of this paragraph) and from the denominator of the proportionate profits fraction, without attributing profits to the cost of such transportation. Similar transportation cost adjustments may be made, if appropriate, in the case of methods of computation which are approved under paragraph (d) (2) of this section and which are based on the taxpayer's costs. For the treatment of costs and profits attributtable to transportation which does not meet the requirements of subdivision (iii) of this subparagraph, see paragraph (d) (4) (i) of this section.

(iii) For purposes of this section, the term "purchased transportation to the customer" means, in general, nonmining transportation from the taxpayer's mine or plant to the customer—

(a) Which is performed in conveyances owned or leased by persons other than the taxpayer, rather than in conveyances owned or leased by the taxpayer;

(b) Which is performed solely to deliver the taxpayer's minerals or mineral products to the

customer, rather than to transport such minerals or products for packaging or other additional processing by the taxpayer (other than incidental storage or handling); and

(c) Which is charged to the customer in such a way that the taxpayer ordinarily does not earn any profit with respect to such transportation.

For purposes of the preceding sentence, transportation which is performed by a person controlling or controlled by the taxpayer (within the meaning of paragraph (a)(3) of § 1.482-1) shall be deemed to have been performed in conveyances owned or leased by the taxpayer unless it is established by the taxpayer that the price charged by the controlling or controlled person for such transportation constitutes an arm's-length charge (under the standard described in paragraph (b)(1) of § 1.482-1). The term "purchased transportation to the customer" includes transportation to a warehouse, terminal, or distribution facility owned or operated by the taxpayer, provided that such transportation is performed under the conditions described in the first sentence of this subdivision. The taxpayer must demonstrate the nonprofit character of the transportation services, as described in (c) of this subdivision, in light of all the facts and circumstances. It shall be presumed that the requirements set forth in either (a) or (c) of this subdivision (relating, respectively, to conveyance ownership and profits) are not satisfied if the taxpayer requires customers to purchase minerals or mineral products only on a delivered basis, by failing to offer such minerals or products for sale on the basis of a price f.o.b. the

taxpayer's mine or plant, or by other means. In the case of taxpayers computing gross income from mining under the provisions of paragraph (d) of this section, the term "purchased transportation to the customer" refers to transportation which conforms with the other requirements of this subdivision and which is performed to transport the taxpayer's first marketable product or group of products (as defined in paragraph (d)(1)(iv) of this section) rather than to transport minerals or mineral products which do not yet constitute the taxpayer's first marketable product or group of products.

* * * * *

(g) *Nonmining processes*—* * *

* * * * *

(3) *Transportation for the purpose of marketing or distribution; storage.* Transportation the primary purpose of which is marketing, distribution, or delivery for the application of only nonmining processes shall not be considered as mining. Nor shall transportation be considered as mining merely because, during the course of such transportation, some extraneous matter is removed from the ore or mineral by the operation of forces of nature, such as evaporation, drainage, or gravity flow. Similarly, storage or warehousing of manufactured products shall not be considered as mining. The preceding sentence shall apply even though, during the course of such storage or warehousing, some extraneous matter is removed from the ore or

mineral by the operation of forces of nature, such as evaporation, drainage, or gravity flow.

* * * * *

§ 1.613-4 *Gross income from the property in the case of minerals other than oil and gas.*

* * * * *

(d) *Cases where a representative market or field price cannot be ascertained*—* * *

* * * * *

(3) *Treatment of particular items in computing gross income from the mining by use of methods based on the taxpayer's costs.* (i) Except as specifically provided elsewhere in this section, when determining gross income from mining by use of methods based on the taxpayer's costs, the costs attributable to mining transportation shall be treated as mining costs, and the costs attributable to nonmining transportation shall be treated as nonmining costs. Accordingly, except as specifically provided elsewhere in this section, all profits attributable to mining transportation shall be treated as mining profits, and all profits attributable to nonmining transportation shall be treated as nonmining profits. For this purpose, mining transportation means so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to plants or mills in which other mining processes are applied thereto as is not in excess of 50 miles or, if the taxpayer files an application pursuant to paragraph (h) of this section and the Commissioner finds that both the physical and other requirements are such that the ores or minerals

must be transported a greater distance to such plants or mills, the transportation over the greater distance. Further, for this purpose, nonmining transportation includes the transportation (whether or not by common carrier) of ores, minerals, or the products produced therefrom, from the point of extraction from the ground to nonmining facilities, or from a mining facility to a nonmining facility, or from one nonmining facility to another, or from a nonmining facility to the customers who purchase the taxpayer's first marketable product or group of products. See paragraph (e)(2) of this section for provisions relating to purchased transportation to the customer and paragraph (g)(3) of this section for provisions relating to transportation the primary purpose of which is marketing or distribution. In the absence of other methods which clearly reflect the costs of the various phases of transportation, the cost attributable to nonmining transportation shall be an amount which is in the same ratio to the costs incurred for the total transportation as the distance of the nonmining transportation is to the distance of the total transportation. As an example, where the plants or mills in which mining processes are applied to ores or minerals are in excess of 50 miles from the point of extraction from the ground (or in excess of a greater distance approved by the Commissioner), the costs incurred for transportation to those plants or mills in excess of 50 miles (or of that greater distance) shall be treated as nonmining costs in determining gross income from mining. Accordingly, all profits attribut-

able to that excess transportation are treated as nonmining profits. However, except in the case of transportation performed in conveyances owned or leased by the taxpayer, the preceding sentence shall apply only to taxable years beginning after November 30, 1968.

* * * * *

(iii) In determining gross income from mining by use of methods based on the taxpayer's costs—

(a) The costs attributable to containers, bags, packages, pallets, and similar items as well as the costs of materials and labor attributable to bagging, packaging, palletizing, or similar operations shall be considered as nonmining costs.

(b) The costs attributable to the bulk loading of manufactured products shall be considered as nonmining costs.

(c) The costs attributable to the operation of warehouses or distribution terminals for manufactured products shall be considered as nonmining costs.

Accordingly, all profits attributable thereto are treated as nonmining profits.

(iv) In computing gross income from mining by the use of methods based on the taxpayer's costs, the principles set forth in paragraph (c) of § 1.613-5 shall apply when determining whether selling expenses and trade association dues are to be treated, in whole or in part, as mining costs or as nonmining costs. To the extent that selling expenses and trade association dues are treated as nonmining costs, all profits

attributable thereto are treated as nonmining profits.

* * * * *

(4) *Proportionate profits method.* (i) The objective of the "proportionate profits method" of computation is to ascertain gross income from mining by applying the principle that each dollar of the total costs paid or incurred to produce, sell, and transport the first marketable product or group of products (as defined in subdivision (iv) of this subparagraph) earns the same percentage of profit. Accordingly, in the proportionate profits method no ranking of costs is permissible which results in excluding or minimizing the effect of any costs incurred to produce, sell, and transport the first marketable product or group of products. For purposes of this subparagraph, members of a controlled group shall be treated as divisions of a single taxpayer. See paragraph (j) of this section for the definitions of the terms "controlled" and "group."

(ii) The proportionate profits method of computation is applied by multiplying the taxpayer's gross sales (actual or constructive) of his first marketable product or group of products (after making the adjustments required by paragraph (e) of this section) by a fraction whose numerator is the sum of all the costs allocable to those mining processes which are applied to produce, sell, and transport the first marketable product or group of products, and whose denominator is the total of all the mining and nonmining costs paid or incurred to produce, sell, and transport the first marketable product or group of products (after making the adjustments required by

this paragraph and paragraph (e) of this section). The method as described herein is merely a restatement of the method formerly set forth in the second sentence of Regulations 118, section 39.23(m)-1 (e)(3) (1939 Code). The proportionate profits method of computation may be illustrated by the following equation:

$$\frac{\text{Mining Costs}}{\text{Total Costs}} \times \text{Gross Sales} = \text{Gross Income from Mining.}$$

(iii) Those costs which are paid or incurred by the taxpayer to produce, sell, and transport the first marketable product or group of products, and which are not directly identifiable with either a particular mining process or a particular nonmining process shall, in the absence of a specific provision of this section providing an apportionment method, be apportioned to mining and to nonmining by use of a method which is reasonable under the circumstances. One method which may be reasonable in a particular case is an allocation based on the proportion that the direct costs of mining processes and the direct costs of nonmining processes bear to each other. For example, the salary of a corporate officer engaged in overseeing all of the taxpayer's processes is an expense which may reasonably be apportioned on the basis of the ratio between the direct costs of mining and nonmining processes. On the other hand, an expense such as workmen's compensation premiums would normally be apportioned on the basis of direct labor costs. For the rule relating to selling expenses, see paragraph (c)(4) of § 1.613-5.

(iv) As used in this section, the term "first marketable product or group of products" means the product (or group of essentially the same products) produced by the taxpayer as a result of the application of nonmining processes, in the form or condition in which such product or products are first marketed in significant quantities by the taxpayer or by others in the taxpayer's marketing areas. For this purpose, bulk and packaged products are considered to be essentially the same product. Sales between members of a controlled group (as defined in paragraph (j) of this section) shall not be considered in making a determination under this subdivision. The first marketable product or group of products does not include any product which results from additional manufacturing or other nonmining processes applied to the product or products first marketed in significant quantities by the taxpayer or others in the taxpayer's marketing area. For example, if a cement manufacturer sells his own finished cement in bulk and bags and also sells concrete blocks or dry ready-mix aggregates containing additives, the finished cement in bulk and bags, constitutes the first marketable product or group of products produced by him. Similarly, if an integrated iron ore and steel producer sells both pig iron in various sizes and rolled sheet iron or shapes, his first marketable product is the pig iron in its various sizes. Further, if an integrated clay and brick producer sells both unglazed bricks and tiles of various shapes and sizes and additionally manufactured bricks and tiles which are specially glazed, the unglazed products, both

packaged and unpackaged, constitute his first marketable product or group of products.

(v) (a) As used in this subparagraph, the term "gross sales (actual or constructive)" means the total of the taxpayer's actual competitive sales to others of the first marketable product or group of products, plus the taxpayer's constructive sales of the first marketable product or group of products used or retained for use in his own subsequent operations, subject to the adjustments required by paragraph (e) of this section. See (b) of this subdivision in the case of actual sales between members of controlled groups and in the case of constructive sales. A "constructive sale" occurs when a miner-manufacturer is deemed, for percentage depletion purposes, to be selling the first marketable product or group of products to himself.

(b) In the case of sales between members of a controlled group as to which the district director has exercised his authority under section 482 and the regulations thereunder and has determined the appropriate price with respect to specific sales transactions, that price shall be deemed, for those transactions, to be the actual amount for which the first marketable product or group of products is sold for purposes of this subdivision (v). In the case of all other sales between members of a controlled group, and in the case of constructive sales, the prices for such sales shall be determined by use of the principles set forth in paragraph (c) of this section, subject to the adjustments required by paragraph (e) of this section. In the case of constructive sales, see paragraph (c)(4) of this section for

rules relating to information to be furnished by the taxpayer.

* * * * *

(e) *Reductions of sales price in computing gross income from mining*— * * *

* * * * *

(2) *Purchased transportation to the customer.** * *

* * * * *

(ii) If a taxpayer computes gross income from mining under the provisions of paragraph (d) of this section, the cost of purchased transportation to the customer (as defined in subdivision (iii) of this subparagraph) shall be excluded from the gross sales of his first marketable product or group of products (after any adjustments required by subparagraph (1) of this paragraph), and from the denominator of the proportionate profits fraction, so as not to attribute profits to the cost of that transporation. Similar transportation cost adjustments may be made, if appropriate, in the case of other methods of computation which are based on the taxpayer's costs. For the treatment of costs and profits attributable to transportation which is not purchased transportation to the customer as defined in subdivision (iii) of this subparagraph, see paragraph (d) (3) (i) of this section.

(iii) For purposes of this section, the term "purchased transportation to the customer" means, in general, nonmining transportation of the taxpayer's minerals or mineral products to the customer—

(a) Which is not performed in conveyances owned or leased directly or indirectly, in whole or in part, by the taxpayer.

(b) Which is performed solely to deliver the taxpayer's minerals or mineral products to the customer, rather than to transport such minerals or products for packaging or other additional processing by the taxpayer (other than incidental storage or handling), and

(c) With respect to which the taxpayer ordinarily does not earn any profit.

For purposes of the preceding sentence, transportation which is performed by a person controlling or controlled by the taxpayer (within the meaning of paragraph (j)(1) of this section) shall be deemed to have been performed in conveyances owned or leased by the taxpayer unless it is established by the taxpayer that the price charged by the controlling or controlled person for such transportation constitutes an arm's-length charge (under the standard described in paragraph (b)(1) of § 1.482-1). The term "purchased transportation to the customer" includes transportation to a warehouse, terminal, or distribution facility owned or operated by the taxpayer, provided that such transportation is performed under the conditions described in the first sentence of this subdivision. A taxpayer will not be deemed ordinarily to earn a profit on transportation merely because charges for the transportation are included in the stated selling price, rather than being separately stated or segregated from other billing. A taxpayer will not be deemed ordinarily to earn a profit on transportation if the rates for the transporta-

tion constitute an arm's-length charge ordinarily paid by shippers of the same product in similar circumstances. If a taxpayer computes gross income from mining under the provisions of paragraph (d) of this section, the term "purchased transportation to the customer" refers to transportation which conforms to the other requirements of this subdivision and which is performed to transport the taxpayer's first marketable product or group of products (as defined in paragraph (d)(4)(ix) of this section) rather than to transport minerals or mineral products which do not yet constitute the taxpayer's first marketable product or group of products.

* * * * *

(g) *Nonmining processes*—* * *

* * * * *

(3) *Transportation for the purpose of marketing or distribution; storage.* Transportation the primary purpose of which is marketing, distribution, or delivery for the application of only nonmining processes shall not be considered as mining. Nor shall transportation be considered as mining merely because, during the course of such transportation, some extraneous matter is removed from the ore or mineral by the operation of forces of nature, such as evaporation, drainage, or gravity flow. Similarly, storage or warehousing of manufactured products shall not be considered as mining. The preceding sentence shall apply even though, during the course of such storage or warehousing, some extraneous matter is removed from the ore or mineral by

the operation of forces of nature, such as evaporation, drainage, or gravity flow.

(4) *Manufacturing, etc.* The production, packaging, distribution, and marketing of manufactured products, and the processes necessary or incidental thereto, are nonmining processes.

* * * * *

§ 1.613-5 *Taxable income from the property.*

* * * * *

(c) *Treatment of particular items in computing taxable income from the property.* * * *

* * * * *

(4) * * *

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(ii) A reasonable portion of the expenses of selling a refined, manufactured or fabricated product shall be subtracted from gross income from the property. Such reasonable portion shall be equivalent to the typical selling expenses which are incurred by unintegrated miners or producers in the same mineral industry so as to maintain equality in the tax treatment of unintegrated miners or producers in comparison with integrated miner-manufacturers or producer-manufacturers. If unintegrated miners or producers in the same mineral industry do not typically incur any selling expenses, then no portion of the expenses of selling a refined, manufactured, or fabricated product shall be subtracted from gross income from the property when determining the taxpayer's taxable income from the property.

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